#2547 signed 3-27-01

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS

In Re:	
ROBERT DANNY ROBINSON,	**CASE NO. 97-40660-13**
DEBTOR.	**CHAPTER 13**
ROBERT DANNY ROBINSON,	
PLAINTIFF,	
v.	**ADV. NO. 97-7072**
DONNA THOMPSON, Probate Administrator, CTA, for the Estate of WARD A. THOMPSON (Deceased),	
DEFENDANT.	

MEMORANDUM OF DECISION

This proceeding is before the Court for decision based on various materials submitted by the parties and prior presentations to the Court at various hearings. The plaintiff-debtor appears by counsel John Hooge. Defendant Donna Thompson, Probate Administrator, CTA, for the Estate of Ward A. Thompson (deceased), appears by counsel Chris Miller. The Court has reviewed the relevant materials and pleadings, considered counsels' arguments, and is now ready to rule.

FACTS

Debtor Robert Danny Robinson has managed to achieve some surprising things in his life despite, or so he claims, being essentially unable to read or write. He also professes to have little ability

to remember dates or to recall even approximately when many events occurred. He completed the eighth grade in school, and then participated in the Job Corps for some period of time. He obtained a regular driver's license at an early age, and later obtained a commercial driver's license and an airplane pilot's license. He claims he passed multiple-choice written exams required for the latter two by memorizing which letter answer was correct for each numbered question, thus avoiding any need to read the exams. He worked for the Hallmark Company for twenty-one years, accumulating a large amount of money in a pension or profit-sharing plan. He was also married and had at least one child.

So far as appears in the record, Robinson's troubles—and they are many—began when he was fired by Hallmark in about 1993 or 1994 for what he was told was sexual harassment. He and his wife got divorced; the decree was entered in August 1995. He withdrew his pension or profit-sharing money, almost $129,000, in 1995, incurring large federal and state income tax obligations that he did not pay. Then in February 1996, he was arrested and charged with possession of cocaine, possession of marijuana, possession of drug paraphernalia, and seven counts of illegal possession of wild animals.

Ward A. Thompson was then in the bail bond business. He provided Robinson with a $5,000 appearance bond, taking a quit-claim deed to Robinson's house on some acreage in rural Jefferson County, Kansas ("the Property"), as security for Robinson's obligations. In applying for the bond, Robinson informed Thompson that he was a self-employed truck driver, but did not indicate how much he earned from his work. Thompson charged $500 for the bond, and also advanced Robinson some money. According to the bond agreement, Robinson was to repay Thompson the $345 advance by March 13. Robinson's girlfriend, Tina French, signed the bond as a co-surety with Thompson, and agreed to indemnify Thompson if Robinson defaulted on his obligations. Robinson claimed he told

Thompson right away that he could not read or write, but Thompson alleged that he did not learn of that claim until October 1996.

On March 12th, Robinson and French signed an "addendum" to the bond agreement that said they were borrowing $700 from Thompson, due on March 15th. Thompson prepared the addendum. On default, the borrowers were to "relinquish the collateral" pledged under the bond agreement. Also on March 12th, Thompson recorded Robinson's quit-claim deed to the Property with the Register of Deeds. Robinson apparently repaid Thompson the initial $345 advance at some time, but the exact date is not contained in the record. The charges against Robinson were eventually dismissed, perhaps in September 1996, although the copy of a journal entry submitted to support that date seems to concern a traffic case, not a criminal one.

Robinson and French apparently borrowed more money from Thompson on many occasions from the end of March through the middle of May, signing a similar "addendum" each time, but these documents have not been presented to the Court. Thompson testified that he also provided an appearance bond for French after she was arrested and that Robinson pledged the Property to secure that bond; some documentation of this transaction was attached to a memorandum Thompson filed in support of a motion for stay relief. French purportedly fulfilled her bond obligations in January 1997.

No specific evidence was presented about Thompson's dealings, if any, with Robinson and French from the middle of May to the end of June 1996, although there were hints that he may have made other loans to them during that time. However, beginning on July 4th, and continuing until November, he definitely made a large number of loans to them, generally for under $1,000 each, and often for a few hundred dollars or less. Robinson testified that they did not always initiate the loan

transactions, but that Thompson sometimes called or visited them and asked if they needed money that day. Thompson required Robinson and French to sign at least one document that he had prepared each time they got more money. The documents they signed have various titles, such as "Addendum," "Agreement," "Promissory Note and Agreement," and "Real Estate Rental Agreement." Many provisions that are similarly worded and whose meaning is far from clear appear off and on in the documents, and the documents' titles give little hint which of these provisions they might contain. The fact a loan is being documented is always made clear when that is the purpose of the document, and the rental agreements make clear that Robinson and French are purportedly renting the Property from Thompson. Robinson conceded that French is able to read and write, but he testified that she read only the first few of the documents that Thompson had them sign. As indicated, Robinson contended he was not able to read any of the documents. Neither party appears to have made any attempt to present any testimony from French in a state court lawsuit Thompson brought against Robinson and French, or before this Court.

The July documents submitted to the Court contain a number of significant provisions. The July 4th document, titled "Addendum," amended the bond agreements of February 26th (Robinson's) and April 29th (apparently French's). It said that Robinson and French were borrowing $1,087.50, due on August 1st, 1996, and that the Property was pledged as collateral for the loan. It also contained the following paragraph (quoted verbatim):

> It is further agreed between the parties that the terms and conditions of the Surety Bond Agreement, Promissory Note/ Security Agreement, as reads: "Otherwise this Agreement shall terminate only upon the Defendant's completion of his/her court obligations". Is amended to read: "Otherwise upon completion of his/her court obligations and upon expiration of the Statute of Limitations, at that time, unless otherwise indicated above, this addendum shall

> become due and payable". All other terms and conditions of the Surety Bond Agreement, Application for Surety Bond and Application for Indemnitor shall remain in force, as agreed to by the parties concerned.

This confused and confusing provision was repeated in many of the subsequent documents the parties signed. It appears to be intended to change the agreements so the completion of Robinson and French's obligations on their appearance bonds would not terminate the agreements, but it is difficult to say what else it would accomplish. The "addendum" (and at least most of the other documents) already specified a date when the loan repayment was "due and payable."

Two days after the July 4th document, Robinson and French signed another "Addendum" that said they were borrowing $1,525, due August 1st, and that they had transferred the Property to Thompson and would relinquish it if they defaulted on the bond agreements or the loan. The next day, they signed an "Agreement" that said: (1) they were borrowing $1,837, due August 1st; (2) they had transferred the Property to Thompson; (3) the Agreement would constitute a bill of sale to the Property; (4) if they defaulted on the Agreement, they would relinquish possession of the Property on demand; and (5) as of the date of the quit-claim deed to the Property, Thompson had the option to rent it to Robinson and French for $750 per month. Thompson testified that at least for these two documents, the amount being borrowed was cumulative, that is, the second one included the $1,525 stated on the first one, plus new money of a little over $300.

Almost three weeks later, Robinson and Thompson signed an "Agreement" that said: (1) they were borrowing $1,000, due September 1st; (2) they had transferred the Property to Thompson; (3) they would relinquish possession to him if they defaulted on the agreement; (4) Thompson was the

owner of the Property; and (5) he had the option to rent the Property to them effective March 1st, 1996. Specifically, the Agreement contained the following paragraph:

> It is agreed that if this agreement is in default Lender [sic] then the Borrowers upon demand by Lender shall relinquish possession of said real estate to Lender. Then Lender hereinafter shall be referred to as Owner and the Borrowers shall be referred to as Renters. Owner at his option may rent the property, effective March 1st, 1996 to the renters for a monthly sum of Seven Hundred Fifty Dollars. Renters shall forever hold the owner harmless from all legal action or legal remedies whatsoever and shall honor the terms and conditions of this agreement.

Under this provision, it is not clear whether Thompson would become the owner of the Property only on default, or was already the owner. Versions of this provision appeared in some of the subsequent documents. Nothing in any of the July documents indicates that Robinson and French owed Thompson any less money as a result of the transfer of the Property.

In August 1996, Robinson and French borrowed money from Thompson on fifteen different days, signing an "Agreement," "Promissory Note," or "Promissory Note and Agreement" each time. Given the consistently increasing amount stated as the amount loaned and the huge total that would have been owed if the stated amounts were not cumulative, the Court concludes all the loan documents for this month state the cumulative total owed for all the loans made up to the date of each document. With the exception of one loan made on August 9th, this interpretation makes the amount of new money that Thompson loaned at any one time almost always under $1,000, consistent with the large number of loans he subsequently made to them. The first August loan document stated that Robinson and French were borrowing $1,375, but by the last document dated in August, they owed Thompson $19,267.

On August 9th, Robinson and French signed four documents, apparently borrowing money three times, and Robinson also assigned a 1979 Chevrolet Corvette to Thompson. The three loans

appear to have been for $475, $750, and $5,437.50. Because the Corvette assignment occurred that day, the Court concludes the larger loan was probably made to enable Robinson to pay a creditor that had apparently repaired the car and was holding it to secure payment of its bill. Some of the money reported in the August 9th documents was due on September 1st, but the balance was not due until December. Later, the due date for all the money mentioned in the August documents was changed to December.

A "Promissory Note" dated August 20th for the first time expressly declared that the total amount stated in it had been loaned over a period of time, rather than all at once. Until this date, the Court could only infer, as noted above, that the loan amount stated in a document was a cumulative total. All the documents after this August 20th one state that the amount owed had been loaned at various times.

On August 27th, 1996, Robinson and French first signed an agreement to rent the Property from Thompson. On the same day, they also signed a "Real Estate Agreement Option to Purchase" that stated their price to purchase the Property from Thompson would be the higher of the county tax appraisal or the fair market value when the option was exercised. Most, if not all, of the loan documents after this date said a default on the loan could be declared to be a default on the rental agreement. At least some of the documents after August 27th provide that on default, the price Robinson and French would have to pay to buy the Property under the option to purchase would be the principal due on the loans plus interest, plus the amount due on the rental agreement plus interest, plus the amount due under the option to purchase agreement. Whatever the true understandings

between the parties may have been, from this date forward, Thompson clearly wanted documentation that showed he owned the Property.

In September 1996, Robinson and French borrowed money from Thompson on nineteen different days, signing a "Promissory Note and Agreement" each time. By the last of these documents, they owed him $34,750. On September 5th, they signed another rental agreement for the Property. This rental agreement contained an option for Robinson and French to obtain an option to purchase the Property by paying 2% of the county tax appraisal; their price to buy the Property would be the higher of the tax appraisal or the fair market value. Robinson sold (or perhaps pledged) a lawn mower and a motorcycle to Thompson, retaining an option to buy them back.

In October 1996, Robinson and French borrowed money from Thompson on twelve different days, signing a "Promissory Note and Agreement" each time. By the last of these documents, they owed him $38,950. Thompson sent them a past-due rental payment notice on October 5th, and a notice on October 11th that he had declared the rental agreement in default. Nevertheless, he continued to loan them more money. He had them sign another rental agreement on October 18th, but it still said the first month's rent was due on October 1st.

On November 2nd at 7:00 a.m., Thompson handed Robinson a notice to pay the rent within three days or the rental agreement would be terminated. That same day (at an unspecified time), he made one last loan to them, bringing the balance they owed him to $39,100. On November 9th, he mailed them a notice to vacate by the 15th. On December 5th, he mailed them another notice to pay rent, giving them until December 15th to do so.

Meanwhile, probably sometime in August, but certainly by September, Thompson had applied for a commercial loan from the Douglas County Bank, giving a mortgage on the Property to secure the loan. As indicated by Douglas County Bank's proof of claim, on September 16th, 1996, Thompson and his wife granted the mortgage and also assigned the rents from the Property to secure a commercial loan or line of credit. The assignment of rents specifically referred to the September 5th rental agreement between Thompson, Robinson, and French. The mortgage covered a maximum principal amount of $40,000. A promissory note renewing the line of credit a month later indicated the debt was then $34,843.65.

On December 17th, 1996, Thompson filed a forcible detainer suit against Robinson and French in state court under the Kansas code of civil procedure for limited actions, seeking to evict them and to recover damages. A default judgment was entered but later set aside. Robinson answered and counterclaimed for a declaration that Thompson had no interest in the Property. He alleged that Thompson had acted with the intent to defraud him, apparently by taking advantage of his purported inability to read. Thompson later amended his complaint to seek: (1) a declaration that he owned the Property; (2) a judgment for rent and other charges due under the rental agreement; (3) eviction of Robinson and French; and (4) damages for fraud on the ground that Robinson and French never intended to fulfill their promises to repay the money he loaned them. Thus, he was claiming the Property as his, and insisting that Robinson and French were obliged to repay the loans he had made to them, too. However, he never alleged or provided any proof that he gave Robinson anything for the Property independent of the loans. At a hearing before the state court some months later, Thompson testified that the county had appraised the Property (apparently during 1997) at $92,000 for tax

purposes. By the time Thompson filed his amended complaint, the case was proceeding under the general Kansas code of civil procedure, not the limited actions one.

In March 1997, Robinson filed a chapter 13 bankruptcy petition. He listed the Property on his schedules and, relying on K.S.A. 60-2301, claimed it to be his exempt homestead; he listed its market value as $80,000. He reported owning a dump truck worth $25,000 on which his attorney had a lien for fees. He also noted his dispute with Thompson on the schedules. He filed a plan in which he proposed to sell the Property after Thompson's claims were determined, and to apply at least $27,000 of the proceeds to pay administrative claims, then priority claims, and then allowed unsecured claims. Except to the extent that certain pleadings Thompson filed can be construed to attack Robinson's right to claim the Property as his exempt homestead, no objections to Robinson's exemptions were filed within the time fixed by Fed. R. Bankr. P. 4003(b).

Shortly after filing for bankruptcy, Robinson filed a motion to avoid any lien, mortgage, or security interest that Thompson might claim in the Property. He argued that he had repaid Thompson on the bond agreement and all subsequent loans before July 1st, 1996, and that two subsequent loans secured by the Property were not yet due when Thompson put a provision in a document for a third loan declaring that the quit-claim deed had made him the owner of the Property. Thompson did not reduce the amount the document showed Robinson owed him, and the stated transfer of the Property was therefore, Robinson argued, made without consideration. He contended Thompson had relied on Robinson's inability to read in preparing the document in an effort to defraud Robinson and obtain the Property without paying anything for it.

Thompson filed a response to Robinson's motion and also filed his own motion for stay relief. In his response, he contended that the Property had been transferred to him when Robinson gave him the quit-claim deed in February 1996, and that Robinson was asking the Court to exercise jurisdiction over a dispute that was already being litigated and that involved a transfer that occurred long before the bankruptcy was filed. In his stay relief motion, he argued that: (1) the Property had been unoccupied for several months and was rapidly deteriorating, (2) Robinson had no equity in the Property because the deed had transferred it to Thompson and the option to pay his debt and regain title to it had been forfeited by his failure to pay, and (3) in the interests of judicial economy, the Court should allow the state court action to proceed to its conclusion. By attacking Robinson's ownership of the Property within the time fixed by Bankruptcy Rule 4003(b), Thompson in effect attacked his right to claim it as exempt, but only on the ground that Robinson did not own it. As of the date of this opinion, neither Thompson nor his probate estate has filed a formal proof of claim against Robinson's bankruptcy estate.

At a hearing in May 1997, this Court granted stay relief only for the parties to proceed with discovery in the state court case. The Court also pointed out that Robinson's attempt to avoid any lien Thompson might have needed to be filed as an adversary proceeding rather than a motion. Robinson filed this proceeding about a month later.

Robinson's complaint essentially repeated his allegations that Thompson had tried to defraud him of the Property, and that any mortgage or security interest that Thompson might have obtained was not perfected and should be avoided under 11 U.S.C.A. §544. In his answer, Thompson denied that the Property was property of the bankruptcy estate or was within this Court's jurisdiction, and denied

that the Court had any jurisdiction to determine the ownership of the Property. He also asserted a counterclaim seeking a determination that Robinson's debt to him was nondischargeable because Robinson had obtained money from him by falsely representing an intent to repay money loaned, and had entered into written agreements intending to willfully and maliciously injure him.

Ultimately, the Court decided to abstain from deciding whether Robinson or Thompson owned the Property and permitted the state court to determine Robinson's claims to legal or equitable ownership. The parties and the state court expressed some confusion about what they were supposed to litigate, and this Court spoke to the state court judge and sent the parties an explanatory letter. The Court said:

> [The state court judge] is prepared to try the ownership question and if ownership is in Mr. Thompson, the forcible detainer action and any damages arising therefrom. If Mr. Thompson is determined not to be the owner, the question of perfection against the property of the bankruptcy estate is a question for the bankruptcy court. The question of misrepresentation and damages therefrom, the exception to discharge question, is also a bankruptcy matter.

In December 1997, acting on this Court's decision to abstain, the parties appeared for a hearing before the state court. At the start of the trial, through his attorney, Thompson for the first time conceded that he did not own the Property, and that the deed had been used only as security for the loans he made to Robinson and French. Because this Court had intended for the state court to determine only whether Robinson or Thompson owned the Property, this concession could have marked the end of the state court proceeding. Nevertheless, the parties presented testimony from Thompson, Robinson, and Robinson's mother, and the court ruled not only that Robinson still owned the Property but also that the quit-claim deed gave Thompson an equitable mortgage on the Property and that the debtor owed Thompson $39,100, the debt secured by the mortgage.

At the hearing, Thompson testified that he had loaned Robinson and French the $39,100 for food, gas, and utility expenses, to get Robinson's tools out of hock, and to pay a bill "against" Robinson's Corvette, apparently for repairs a third party had made to the car. Robinson testified that he and French had borrowed money not only to pay bills, but also to buy drugs. He claimed that Thompson knew they were using some of the money to buy drugs because at times, they called their drug dealer from his office while he was present. Considering the large number of separate loans Robinson and French obtained, and the total amount of the loans in some months—over $17,000 in August 1996, over $15,000 in September 1996, and over $5,000 in October 1996—the Court believes it is highly unlikely that Thompson really thought they were borrowing to pay only relatively ordinary living expenses plus the car repair and tool redemption expenses. In fact, considering that Thompson knew from the start that Robinson had been arrested on drug charges, the Court is convinced it is more likely than not that Thompson at the very least suspected, if he did not actually know, that the pair were using at least some of the money to buy drugs. The Court is also convinced that Thompson tried to take advantage of Robinson's limited reading skills and French's probable failure to read most of the documents very carefully, if at all, and perhaps their drug problems, and take the Property from Robinson for, at most, under one-half the value he thought it had, or perhaps for nothing at all. The Court simply cannot believe that Thompson really thought Robinson and French would be able to repay from their earned income the $39,100 he loaned them in more than 35 transactions over a three-month period, especially if he had truly thought they were borrowing to pay ordinary living expenses. If they had any ability to repay, they should not have needed to borrow so much in such a short time.

On the other hand, the Court also cannot believe Robinson's testimony that he thought the Property was to serve as collateral only for the appearance bond, and not for any of the money Thompson subsequently loaned him and French. Robinson did testify that he did not think they had borrowed so much from Thompson, but he conceded their signatures appeared on the multitude of documents Thompson had prepared, and that Thompson had had them sign something whenever they borrowed more money. According to Robinson's bankruptcy schedules, his income from employment in 1996 was only $6,476. According to a document French completed for Thompson when he first provided the appearance bond for Robinson, she had two young children, was living with her parents, and had been working in a cleaning position for twelve years and was still making only $5.50 per hour. Consequently, it seems clear they could not have thought they could repay the loans from their earnings, and Robinson's Property and his dump truck seem to have been the only assets they could have sold or used to obtain money to repay the loans.

Sometime after the state court hearing in December 1997, Thompson died. The Bank filed a demand against Thompson's probate estate for $34,454.02. After the Property was determined to belong to Robinson, the Bank filed a proof of claim against Robinson's bankruptcy estate. The Bank also intervened in this adversary proceeding to claim its mortgage was superior to both Thompson and Robinson's interests in the Property, a question that was resolved in the Bank's favor by a stipulated order. Still later, the Bank was paid by credit life insurance Thompson had purchased, and withdrew its claim against Robinson's bankruptcy estate.

Sometime in the summer or fall of 1997, someone discovered that mercury had been spilled in the house on the Property. The Environmental Protection Agency became involved in getting this

hazardous material cleaned up. Resolution of this proceeding was delayed for a time because the parties were aware that the EPA might assert a lien against the Property for clean-up costs that would have been superior to all their interests in it. Finally, Robinson filed a motion to sell the Property free and clear of all claims or interests, including the EPA's, and the Property was sold. The net proceeds from the sale, about $56,000, are being held by the chapter 13 trustee pending the Court's determination of the parties' entitlement to them.

According to an attorney handling certain matters for Thompson's estate, any money distributed from Robinson's bankruptcy estate to Thompson's probate estate would probably be distributed to Thompson's widow. As indicated earlier, she joined her husband in signing for the loan from the Bank that was secured by the mortgage on the Property.

DISCUSSION AND CONCLUSIONS

Robinson contends that Thompson's probate estate either should have no lien on the proceeds of the Property, or should have one only to the extent of the difference between the $39,100 that he and French owed Thompson and the $34,454.02 that Thompson had borrowed from the Bank using the Property as security. Thompson's estate insists that Thompson was entitled to an equitable mortgage on the Property to the secure the $39,100 debt, and that it should be able to enforce that mortgage against the proceeds of the Property. Under the circumstances presented here, the Court is convinced that Thompson's estate should not be allowed to enforce any lien against the Property, but instead should at most share in Robinson's bankruptcy estate as an unsecured creditor.

Under Kansas law, a deed that is absolute in form can be shown to have been intended merely to serve as security for a loan, and when that is established, the deed will be treated as an equitable mortgage. *Berger v. Bierschbach*, 201 Kan. 740, 743 (1968). In addition, "all actions to foreclose mortgages are equitable in nature." *Hill v. Hill*, 185 Kan. 389, 400 (1959). Because *Hill* involved an equitable mortgage, it is clear that the rule stated applied to equitable mortgages as well as others. Since its earliest days, Kansas law has provided that when the mortgagor defaults, the mortgagee's remedy is to sue for a judgment on the debt and to foreclose its mortgage through a judicial sale subject to the mortgagor's redemption rights. *In re Stanley Station Associates*, 139 B.R. 990, 994-95 (Bankr.D.Kan. 1992); *see also Penn Mutual Life Ins. Co. v. Tittel*, 153 Kan. 530 syl. ¶2 (1941) (mortgage is lien on real property; when foreclosed, legal title does not pass until sheriff's deed is duly issued); *Restatement 3d, Property 3d, Mortgages* §8.2 (1997) (on default, mortgagee may sue any personally liable party, foreclose mortgage, or both). Kansas law has also long provided that strict foreclosure—that is, the mortgagee gaining legal and equitable title to the mortgaged property because the mortgagor failed to redeem in the time fixed by a court—is not available for liens on real property. *Blood v. Shepherd*, 69 Kan. 752, 757 (1904); *see also Restatement 3d, Property 3d, Mortgages* §3.1, comment a (1997) (explaining what "strict foreclosure" of real estate mortgage means).

When an equitable mortgage is foreclosed, the mortgagor is entitled to a redemption period under K.S.A. 60-2414. *Berger v. Bierschbach*, 201 Kan. at 746. Redemption rights are zealously guarded in Kansas. *Farm Credit Bank v. Zerr*, 22 Kan. App. 2d 247, 252 (1996) (citing *Southwest State Bank v. Quinn*, 198 Kan. 359, syl. ¶ 2 (1967); *Broadhurst Foundation v. New Hope Baptist Society*, 194 Kan. 40, 42-43 (1964)). Redemption rights include the right to possession of the

foreclosed property and to retain any rents and profits it may generate. *First Federal Savings & Loan v. Moulds*, 202 Kan. 557, 561 (1969). Individuals like Robinson may not waive their redemption rights when they mortgage agricultural lands or single or two-family dwellings. K.S.A. 60-2414(a); K.S.A. 60-2410(e); *see also Broadhurst Foudation v. New Hope Baptist Society*, 194 Kan. 40, 42-45 (1964) (unlike individual, corporation can waive right of redemption, but corporation cannot waive right to possession and income without waiving redemption right). Furthermore, when the mortgagee sues to enforce the mortgage lien and obtains a judgment, a foreclosure sale must be held, *Stanley Station*, 139 B.R. at 995, and the mortgagor is entitled to any surplus remaining after the proceeds are applied to pay real estate taxes, the costs of the sale, the foreclosing creditor's judgment, and any junior encumbrances being terminated in the action. *See Restatement 3d, Property 3d, Mortgages* §7.4 (1997); *see also id., Introduction*, "Protection for Borrowers" (1997) (mortgage law provides two important protections for mortgagors: equitable right of redemption and right to surplus from foreclosure sale).

Parties like Thompson (and through him, his probate estate) who seek equitable remedies, including enforcement of equitable mortgages, must come before the court with clean hands or be denied the remedies. *Fuqua v. Hanson*, 222 Kan. 653, 656-57 (1977). The clean hands doctrine is to be applied in the sound discretion of the court. 222 Kan. at 657; *see also T.S.I. Holdings, Inc., v. Jenkins*, 260 Kan. 703, 720 (1996) (citing *Fuqua* for these rules). Under the doctrine, "'a litigant may be denied relief by a court of equity on the ground that his conduct has been inequitable, unfair and dishonest, or fraudulent and deceitful as to the controversy in issue.'" *Goben v. Barry*, 234 Kan. 721, 727 (1984) (quoting 27 Am. Jur. 2d, Equity §136, p. 667). Or, as phrased in another case, the party's

conduct "must be willful conduct which is fraudulent, illegal or unconscionable [citation omitted]," and related to the matter in dispute. *Green v. Higgins*, 217 Kan. 217, 221 (1975). Where both parties have acted wrongfully, the court must weigh their wrongful acts, and deny any relief requested by the party whose wrongs equaled or exceeded the other party's. *Goben v. Barry*, 234 Kan. at 727.

> It should also be emphasized that in applying the clean hands maxim, courts are concerned primarily with their own integrity. The doctrine of unclean hands is derived from the unwillingness of a court to give its peculiar relief to a suitor who in the very controversy has so conducted himself as to shock the moral sensibilities of the judge. It has nothing to do with the rights or liabilities of the parties. In applying the unclean hands doctrine, courts act for their own protection, and not as a matter of 'defense' to the defendant. [Citation omitted.]

Green v. Higgins, 217 Kan. at 221.

In this case, Thompson clearly sought to deprive Robinson of the Property in a manner not available under Kansas law. He began fairly enough by taking the quit-claim deed as security for the bond obligations, and getting Robinson to agree it should serve as security for loans as well. However, later, apparently because he felt Robinson had not kept his word to him, he began to modify their agreements so that, without having given Robinson any consideration for its transfer, he would at least appear to be the owner of the Property while Robinson not only continued to owe him all the money he and French had borrowed but also owed him rent for living on the Property. Relying on that appearance, Thompson borrowed money from the Bank secured by a mortgage on the Property, and an assignment of the rents purportedly due from Robinson and French. A few months later, he sought to enforce his claims against Robinson by a limited actions suit for forcible detainer, an action available to him under Kansas law only if he, not Robinson, owned the Property. *See* K.S.A. 61-2302 & -1603(b)(3) & (4) (1994 Furse) (at least in 1996, limited actions did not include actions to recover title

to, or establish interest in, real estate, or actions to foreclose mortgages or establish and foreclose other liens on real estate), *repealed* 2000 Kan. Sess. Laws ch. 161, §117, (eff. Jan. 1, 2001). When Robinson responded by contesting Thompson's ownership of the Property, Thompson sought: (1) a declaration that he, not Robinson, owned it; (2) to evict Robinson and French; and (3) damages for Robinson's alleged fraud in borrowing money from him with no intent to repay.[1] Had Thompson's suit succeeded on these theories, he would have obtained title to and possession of the Property for nothing, and probably a judgment for at least the amount Robinson and French owed him on the loans. Robinson would have lost not only the Property, but also the rights that he would have had in a foreclosure action to redeem the Property and to receive any surplus from its sale. Thompson continued, before this Court as well as the state court, to assert his ownership of the Property until the parties returned to the state court for trial on the ownership question in December 1997. By pressing that claim for more than a year, Thompson forced Robinson to incur at least some attorney fees that would have been unnecessary if he had pursued an equitable mortgage claim instead. Having proceeded so inequitably in his dealings with Robinson about the Property, Thompson did not come before this Court with the clean hands necessary for him to be entitled to obtain equitable remedies to enforce his asserted interest in the Property. The Court is convinced that Thompson's wrongs clearly outweigh any wrong that Robinson might have committed by borrowing money with no intent to repay, especially since Thompson almost certainly did not rely on Robinson's promises to repay as a material consideration in making the loans to him. Thompson's improper actions, however, essentially concern

[1]Apparently because title to the Property was now in question, the suit was renumbered to be one covered by general, not limited actions, jurisdiction.

only the Property, and the Court does not believe they should preclude his probate estate from trying to collect the $39,100 debt from Robinson's bankruptcy estate.

Aside from Thompson's inequitable conduct, there is another reason his probate estate should not recover Robinson's debt to it through a lien on the proceeds of the Property. By obtaining a loan from the Bank that was secured by the Property, Thompson received up to $40,000 from his purported ownership of the Property. After he died, his credit life insurance paid off his obligation to the Bank, so his estate is no longer liable to repay that loan. Thus, he received the use of the loan money while he was alive, and following his death, his estate has escaped the obligation to repay the loan. If his estate also recovered now from the proceeds of the Property, it would benefit again from Thompson's interest in the Property. This double benefit would be inequitable. Instead, Robinson's administrative and priority creditors should be paid first from the proceeds, as he has proposed in his plan. If his bankruptcy estate has sufficient funds to make any distribution to his unsecured creditors, Thompson's probate estate may be entitled to share in that distribution on a pro rata basis.[2]

Thompson's estate suggests that the Kansas collateral source rule precludes the Court from considering the fact it recovered on the credit life insurance. The Court cannot agree. That rule was described in *Gregory v. Carey*, 246 Kan. 504, 508 (1990):

> The collateral source rule is a common-law rule preventing the introduction of payments made to or benefits conferred on the injured party from other sources which are not credited against the tortfeasor's liability, although they cover all or a part of the harm for which the tortfeasor is liable. Stated another way, the collateral source rule provides that benefits received by the plaintiff from a source wholly independent of and collateral to the wrongdoer

[2]The lack of a formal proof of claim may affect this question, but that possibility has not been raised by the parties, so the Court will not address it at this time.

> will not diminish the damages otherwise recoverable from the wrongdoer. *Farley v. Engelken*, 241 Kan. 663, 665-66 (1987)

As indicated, the rule applies only to tort claims. Thompson's claim against Robinson is essentially a contract claim, not a tort claim. Thompson did assert fraud, a tort claim, on the ground that Robinson had no intent to repay when he and French borrowed the money from Thompson. Under Kansas law, though, to establish a fraud claim against Robinson, Thompson had to prove, among other things, that he actually relied on Robinson's promises to repay him and that his reliance was reasonable, justifiable, and detrimental. *Quinn v. City of Kansas City,* 64 F. Supp. 2d 1084, 1091 (D. Kan. 1999) (citing *Slaymaker v. Westgate State Bank,* 241 Kan. 525, 531 (1987)). Under the circumstances of this case, the Court is convinced that Thompson did not actually rely on Robinson's promises, and could not have reasonably and justifiably relied on them. Instead, the Court believes that Thompson actually relied on recovering his money from the Property, while entertaining improper hopes of recovering, and making improper efforts to recover, not only the Property, but also all the money he had loaned to Robinson and French.

For these reasons, the Court concludes that Thompson's estate is not entitled to enforce an equitable mortgage or other lien against the proceeds of the Property. If Robinson's bankruptcy estate has sufficient funds to make any distribution to unsecured creditors, Thompson's estate may be entitled to a pro rata share of that distribution based on an unsecured claim of $39,100 against Robinson.

The foregoing constitutes Findings of Fact and Conclusions of Law under Rule 7052 of the Federal Rules of Bankruptcy Procedure and Rule 52(a) of the Federal Rules of Civil Procedure. A

judgment based on this ruling will be entered on a separate document as required by FRBP 9021 and FRCP 58.

Dated at Topeka, Kansas, this ____ day of March, 2001.

_____
JAMES A. PUSATERI
CHIEF BANKRUPTCY JUDGE